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No. 01-1709

IN THE

# Supreme Court of the United States

AFC COAL PROPERTIES, INC.,

*Petitioner,*

v.

DELTA MINE HOLDING COMPANY
and MEADOWLARK, INC.,

*Respondents.*

**On Petition for Writ Of Certiorari to the United States Court Of Appeals for the Eighth Circuit**

## REPLY BRIEF

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## REPLY BRIEF

### I. RESPONDENTS' COUNTERSTATEMENT OF THE CASE SHOULD BE GIVEN NO WEIGHT

Delta won its appeal below based on the law, not the facts. The district court vacated the arbitration awards because arbitrator Stagg deceived AFC about his relationships with the parties and his interests in the proceedings and the parties. The court of appeals reversed the district court on legal grounds, ruling that the decision to vacate was founded on an incorrect reading of the Federal Arbitration Act and *Commonwealth Coatings Corp. v. Continental Cas. Co.*, 393 U.S. 145 (1968).

The court of appeals limited its review largely to the legal underpinnings for the district court's decision to vacate, including in particular, the Eighth Circuit's unprecedented ruling that the disclosure obligations of *Commonwealth Coatings* do not apply to party-appointed arbitrators. For that reason, the Eighth Circuit left virtually untouched the district court's findings about Stagg's intentional efforts to conceal his relationships and interests.

With this backdrop, Delta's "Counterstatement" of the facts is nothing less than remarkable. Although Delta does not itself seek to raise any Question for consideration in its opposition brief, it nonetheless reargues the facts which the district court already found in favor of Petitioner AFC. Almost half of Delta's Brief in Opposition is devoted to this effort. Indeed, for the most part, Delta simply presents its own version of the facts to this Court as if the courts below had not already adjudicated the facts against Delta.

The key district court fact findings, which were not vacated, are entitled to deference unless clearly erroneous. Pet. at p. 7; *Kiernan v. Piper Jaffray Cos., Inc.*, 137 F.3d

588, 591 (8th Cir. 1998)[1] Accordingly, Delta's attempt to reargue the facts is inappropriate and should be given no weight. *See, e.g., Goldfarb v. Virginia State Bar*, 421 U.S. 773, 784 n.10 (1975); *Phillips Chem. Co. v. Dumas Indep. Sch. Dist.*, 361 U.S. 376, 481 n.12 (1960).

Delta takes great liberties with the record. It contends that although the parties agreed to abide by the AAA Rules (which do not adopt the AAA's Code of Ethics), they never agreed to follow the ethical standards in the Code of Ethics. (Opp. at p. 13) Delta's contention was firmly rejected by the district court:

> At the initial scheduling conference, AFC passed out both the Rules and the Code and made several statements that it believed the Code applied to the arbitrators in this case. . . . Stagg accepted the Code and made a misleading partial disclosure about the nature and extent of his relationship with Delta Mine and Delta Mine's counsel that did not comply with the requirements of the Code. . . . . I find that AFC reasonably believed, *and the parties agreed*, that the party-appointed arbitrators were going to follow the provisions of the Code applicable to non-neutral arbitrators. (App. B at pp. 39a-40a) (emphasis added).

Delta also attempts to reargue that even if the Code of Ethics or *Commonwealth Coatings* applies, Stagg made a sufficient disclosure during the organizational meeting. (Opp. at p. 13, n.10) But Delta ignores that the district court explicitly found otherwise (App. B at p. 40a) and also found that Delta had abandoned this claim. (*Id.* at p. 38a, n.6).

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[1] Citations to "Pet." refer to the Petition; citations to "Opp." refer to Respondents' Brief in Opposition.

Delta further claims that AFC should have known what Stagg had in mind because the arbitration panels purportedly assigned the party arbitrators a role in "*preparing*" their party's case. (Opp. at p. 5) However, the opinions issued by both courts below make clear that the arbitration panels simply requested the party arbitrators to be in a position to question witnesses at the hearing. This is a far cry from Delta's new claim that AFC should therefore have surmised that Stagg and his consulting company SESI would play a substantial role in shaping Delta's case, preparing testimony and witnesses, creating exhibits, and accepting nearly $300,000 in fees to engineer the case Stagg later was called upon to decide as arbitrator. Moreover, Delta wholly disregards Stagg's failure to disclose that he was again hired by Delta's counsel to serve as an expert consultant in another matter for another client before the arbitrations in this case were decided. (Pet. at pp. 5-6)

Contrary to Delta's contentions, the district court found that Stagg and Delta combined to deny AFC the opportunity to discover "the full nature and extent of Stagg's involvement in pre-hearing proceedings and his ongoing relationship with Delta Mine," (App. B at pp. 22a-23a), adding weight to the district court's conclusion that Stagg was guilty of evident partiality. (*Id.* at p. 47a)

## II. DELTA CANNOT RESOLVE THE CONFLICT BETWEEN THE EIGHTH CIRCUIT DECISION AND *COMMONWEALTH COATINGS*

In its opposition brief, Delta seeks to divorce the disclosure standards of *Commonwealth Coatings* from § 10(a) of the FAA. However, while the arbitrator in *Commonwealth Coatings* was the third arbitrator on a tripartite panel, nothing in the reasoning of the Court's opinion suggests that it was establishing a disclosure duty for some but not all arbitrators. FAA § 10(a) condemns evident partiality in all arbitrators and makes no distinction for

arbitrators who are "predisposed," "not impartial," "non-neutral," "partisan," or "party-appointed."

Delta simply ignores the primacy of the FAA and *Commonwealth Coatings* in setting the requirements for whether an arbitration award will be transformed into a federal court judgment. Delta turns the precept on its head when it argues that, "the federal courts are not free to impose such requirements on a party-appointed arbitrator under the guise of Federal Arbitration Act review of an arbitration award." (Opp. at pp. 13-14)

Although Delta eschews any review or analysis of *Commonwealth Coatings*, both the Court's opinion and Justice White's concurrence plainly contemplate a broad but flexible rule of disclosure as a precondition to confirmation under the FAA. Justice White made this clear:

> arbitrators are not automatically disqualified by a business relationship with the parties before them *if both parties are informed of the relationship in advance*, or if . . . the relationship is trivial." 393 U.S. at 150 (emphasis supplied).

Delta's brief, in fact, highlights the conflict between *Commonwealth Coatings* and the appellate decision below. For example, Delta suggests that the Eighth Circuit found Stagg made a "sufficient" disclosure, implying that he made the kind of disclosure required by *Commonwealth Coatings* or the Code of Ethics. (Opp. at p. 15) Of course, the court of appeals said nothing of the kind. The court simply held that if AFC could infer that Stagg was not neutral, then it should expect that he had the same interests and duty of loyalty as an officer, employee or attorney of Delta. (App. A at p. 10a) Stagg's disclosure of a prior consulting relationship with Delta's predecessor, according to the Eighth Circuit, was sufficient to put AFC on notice that Stagg was not neutral. *Id.*

Delta also contends that because the AAA rules provide no mechanism for objecting to a party-appointed arbitrator, no functional purpose is served for the party arbitrator to disclose his interests and relationships. This argument fails for several reasons. First, it again fails to recognize the FAA's primacy. *Commonwealth Coatings* makes clear that the salutary purpose of disclosing relevant relationships and interests is the fundamental assurance that the parties to the arbitration are getting a fair shake and that their reasonable expectations for the process are being met.

Moreover, in this case the parties agreed to apply the Code of Ethics. The Code not only establishes standards of integrity for party arbitrators, but also imposes on them an ongoing duty to disclose.[2] Furthermore, irrespective of any other rights, a party always has the right to challenge arbitrators under the FAA for evident partiality, corruption or other misconduct. Without meaningful disclosures, these rights become illusory.

A number of courts have ruled that FAA § 10(a) and the *Commonwealth Coatings'* disclosure obligations apply equally to party-appointed arbitrators. *See, e.g., Standard Tankers (Bahamas) Co., Ltd. v. Motor Tank Vessel, AKTI*, 438 F. Supp. 153, 159 (E.D. N.C. 1977), *Metropolitan Prop. & Cas. Ins. Co. v. J.C. Penney Cas. Ins. Co.*, 780 F. Supp. 885 (D. Conn. 1991); *Barcon Assocs. Inc v. Tri-County Asphalt Corp.*, 430 A.2d 214 (N.J. 1981). Delta's feeble

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[2] Similarly, the revisions to the Uniform Arbitration Act, U.L.A. § 12 (2000), now require full disclosure by all arbitrators, even though party arbitrators under the UAA cannot be challenged for evident partiality. (Pet. at pp. 17-18)

effort to distinguish these cases[3] only underscores that the Eighth Circuit's decision marks a regressive shift in applying the FAA. In sharp contrast to these decisions, and inconsistent also with *Sunkist Soft Drinks, Inc. v. Sunkist Growers, Inc.*, 10 F.3d 753 (11th Cir. 1993) *cert. denied*, 513 U.S. 869 (1994), the court of appeals has created an exception to the duty of disclosure which actually encourages and even rewards the concealment of substantial relationships and interests by party-appointed arbitrators.

Although Delta acknowledges that evident partiality requires no separate showing of prejudice to vacate an award, it argues that the Eighth Circuit properly restricted this rule to impartial arbitrators (Opp. at p. 16). However, neither Delta, nor the Eighth Circuit, offer any precedent to so limit the disclosure rule in *Commonwealth Coatings*, nor any plausible rationale to warrant probing neutral arbitrators' thought processes to establish the impact of impermissible bias, something that is understandably difficult to ascertain. Evident partiality presumes prejudice; Stagg supplied the deciding vote in the arbitrations.

The recurring problem of a party-appointed arbitrator's concealment of interests is highlighted in a recent

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[3] Delta denigrates *Standard Tankers* as "a 23-year old opinion," (*Commonwealth Coatings* is a 34-year-old opinion), and erroneously asserts that the party arbitrator's duty to disclose found in *Metropolitan Prop. & Cas. Ins. Co.* was based solely on the parties' agreement. (Opp. at p. 14 n.12) To the contrary, the challenged party arbitrator's alleged failure to reveal his *ex parte* activities "violates the rule that an arbitrator must disclose at the time of his appointment 'any circumstances likely to create a presumption of bias or which he believes might disqualify him as an impartial Arbitrator.'" *Metropolitan Prop.* 780 F. Supp. at 893 (quoting *Commonwealth Coatings*, 393 U.S. at 149).

district court case, *Sphere Drake Ins. Ltd. v. All American Life Ins. Co.*, No. 01 C 5226, 2002 U.S. Dist. Lexis 8876 (N.D. Ill. May 17, 2002).[4] In that decision, Ronald Jacks, a retired law firm partner, was the party-appointed arbitrator for Sphere Drake. At the parties' organizational meeting, Jacks made limited disclosures about his prior relationships with Sphere Drake and that he was its party arbitrator in two pending arbitrations, but omitted to disclose that he personally had represented Sphere Drake in an arbitration while an active member of his law firm. *Id.* at *10.

Citing to the "simple requirement" of *Commonwealth Coatings* "that arbitrators disclose to the parties any dealings that might create an impression of possible bias," the court vacated the arbitration award because of Jacks' failure to disclose his substantial relationships with Sphere Drake.[5] *Id.* at *20. There, as here, the court was also concerned about more than Jacks' intimate connection to Sphere Drake: "What is at least as important as the connection itself, however, is the negligent or even intentional inadequacy of Jack's disclosure of the relationship." *Id.* at *28.

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[4] *Sphere Drake* is currently on appeal to the Seventh Circuit and has not been published yet. The district court's decision was docketed on May 20, 2002, too late to include in the Petition.

[5] According to the court, the parties had some right to approve or disapprove of the panel after disclosures were made. *Id.* at *21 n.8. However, all arbitrations are subject to review under the FAA for evident partiality, corruption, misconduct, or the use of undue means. None of these rights, as the court in *Sphere Drake* correctly observed, mean much unless all arbitrators disclose their relationships and interests with frankness and candor.

The issues presented in the Petition are important and a continuing source of litigation in the federal courts. The rule announced by the Eighth Circuit, freeing party arbitrators from any duty of disclosure under the FAA, invites the very chicanery which Stagg here employed and warrants review by this Court.

## III. THE EIGHTH CIRCUIT IMPROPERLY RULED *SUA SPONTE* THAT AFC WAIVED ITS OBJECTION TO STAGG

Delta concludes by arguing that the "Eighth Circuit clearly had the authority" to rule, *sua sponte*, that AFC waived the right to challenge Stagg, going so far as to argue that Petitioner "does *not* suggest that there was legal error." (Opp. at pp. 17, 18) These claims ignore not only this Court's criticism of such action, but also the undisturbed record of these proceedings. Waiver was not apparent to the district court or to Delta in the proceedings below. Delta did not raise the issue. The detailed findings of the district court reveal that after Stagg made his initial "misleading disclosure" (App. B at p. 49a), AFC was able to learn only that Stagg and one of his associates had attended several meetings with Delta, its counsel, and some of their witnesses. Delta's counsel (who also later represented Stagg and SESI) prevented further discovery during the arbitrations regarding the nature of Stagg's activities by asserting privilege claims later found to be meritless. (*Id.* at pp. 22a, 29a-30a)

Delta's suggestion that AFC was then in a position to demand recusal but somehow held back is pure invention. (Opp. at p. 19) As the district court found, AFC wrote the arbitration panels to describe what little it had learned about Stagg's activities, which AFC viewed as improper, in order to request time and authority to "delve into the full nature and extent of Stagg's involvement in pre-hearing proceedings and his on-going relationship." (App. B at

pp. 22a-23a) Although Stagg participated in the panels' consideration of this request, he never disclosed to its members his and SESI's true activities. AFC and the panels remained uninformed regarding this critical information when the arbitrators refused to act on AFC's request. (*Id.* at p. 49a) Unable to obtain a formal response from the panels, AFC had no choice but to proceed with the arbitrations. *Cf. Aviall, Inc. v. Ryder Sys., Inc.*, 110 F.3d 892, 895 (2d Cir. 1997) (party may not seek removal of arbitrator before the issuance of the award under the FAA).

The Eighth Circuit's decision ignores the "general rule . . . that a federal appellate court does not consider an issue not passed on below." *Singleton v. Wulff*, 428 U.S. 106, 120 (1976). This Court has explained that this restraint is critical "in order that parties may have the opportunity to offer all the evidence they believe relevant to the issues which the trial tribunal is alone competent to decide." *Hormel v. Helvering*, 312 U.S. 552, 556 (1941). Exceptions to the general rule exist, but they are few, such "as where the proper resolution is beyond any doubt . . . or 'where injustice might otherwise result.'" *Singleton*, 428 U.S. at 121 (citations omitted). *See also Arizona v. California*, 530 U.S. 392, 395 (2000) (rejecting argument that this Court should raise argument *sua sponte* because the "special circumstances in which such judicial initiative might be appropriate are not present here").

In *Singleton*, this Court criticized the Eighth Circuit for engaging in an "unacceptable exercise of its appellate jurisdiction" when the appellate court proceeded beyond the standing issue presented by a dismissal order on appeal to consider the merits of a challenge to a state abortion statute. 428 U.S. at 119-120. The matter did not present special circumstances which would justify the court's exercise of its discretion. Rather, "injustice was more likely to be caused

than avoided by deciding the issue without the petitioner's having had an opportunity to be heard." *Id.* at 121.

The Eighth Circuit here fails to point to exceptional circumstances to support its extraordinary recognition of an argument never raised in order to reverse the district court. The court of appeals does not find that the district court erred in its factual determinations, let alone explain how its conclusion exists "beyond any doubt" in the face of these contrary findings. *Id.* Having fashioned a waiver theory without regard to the detailed factual findings of the trial court and Respondents' own waiver of this point, the Eighth Circuit abused its discretion.

## CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted,

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